Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

National
Foreign
Assessment
Center

Secret [redacted]

25X1

East Asian Journal [redacted]

25X1

18 November 1981

Secret

EA EAJ 81-022
18 November 1981

Copy 236

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

[redacted] 25X1

East Asian Journal

18 November 1981

Comments and queries regarding this publication, which replaces the China Review *and the* East Asia Review *of the former Office of Political Analysis, may be directed to the Chief of Production, Office of East Asian Analysis, telephone* [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

 [redacted] 25X1

Japan: Evolving Middle East Policy [redacted] 25X1

Reassessment of its Middle East policy is in line with Tokyo's growing recognition that it must play a role in the world commensurate with its economic strength. The bilateral and almost exclusively economic orientation of Japanese diplomacy in the region ended with the Iran hostage crisis and the invasion of Afghanistan. Since then Japanese officials have shown an increasing interest in the Middle East peace process, and the visits of Egyptian Deputy Prime Minister Ali and PLO leader Arafat were but the first in a round of high-level exchanges that will include a Middle East swing by Prime Minister Suzuki sometime next year. Japan will consider US views carefully when making policy choices, but will not automatically echo Washington [redacted] 25X1

Japan: Trade With the Middle East 1980 — Billion US Dollars

Exports (f.o.b.)	**13.7**
Saudi Arabia	4.9
United Arab Emirates	1.4
Iraq	2.2
Iran	1.5
Kuwait	1.3
Egypt	0.7
Qatar	0.2
Oman	0.3
Yemen	0.2
Jordan	0.2
Other	0.8
Imports (f.o.b.)	**38.6**
Saudi Arabia	17.1
United Arab Emirates	7.2
Iraq	3.8
Iran	3.6
Kuwait	3.0
Qatar	1.6
Oman	1.5
Other	0.8

[redacted] 25X1

Trade Ties

Japan in the immediate aftermath of the 1973 oil crisis made hasty attempts to protect its energy lifeline. Policy throughout the 1970s continued to focus on two goals—safeguarding the energy supply and building trade with the Middle East in order to pay for oil. By following a cautious but steady pro-Arab course, the Japanese were able to secure their oil imports. Over 70 percent of their oil comes from the Middle East; Saudi Arabia supplies the bulk. [redacted] 25X1

The need to pay the oil bill, combined with the lucrative Middle East market, brought expansion in both the volume and value of Japanese exports to the region during the 1970s. Exports averaged an annual increase of about 40 percent from 1973 to 1979. Shipments to the Middle East jumped 40 percent in 1980 despite sanctions against Iran, and Japan increased its share of OECD exports to the region from 16 to 18 percent. Japan is now in a position to challenge the United States as the top exporter to the region. The lion's share of Japan's export trade has been with the OPEC members, Saudi Arabia in particular. Exports have been concentrated in the chemical and heavy industrial sectors, with iron and steel, motor vehicles, and plant exports accounting for about 60 percent of sales. [redacted] 25X1

Building Interdependence

By the late 1970s, Tokyo sought to lock oil-producing Arab countries into a relationship that would influence them to remain on good terms with Japan. To that end, Tokyo was committed to creating a dependency both on Japanese exports and on Japanese involvement in development projects. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

In Saudi Arabia, for example, Japanese consortiums are involved in the construction of two major petrochemical plants and Japanese firms will sell half the final product. Such joint ventures are not without risk, however, as demonstrated by the Bandar-Khomeini petrochemical complex in Iran. Rising costs, construction delays, and the Iran-Iraq war are pushing the Mitsui group to withdraw from the project and file an $870 million claim against Japan's export insurance fund. Payment of the claim would make projects in Iran ineligible for future insurance coverage and, as a result, other Japanese firms would curtail dealings there. [redacted] 25X1

Aid and Comprehensive Security

In 1980, Tokyo began to move cautiously into the political sphere by allocating aid to areas "bordering on conflict" to help maintain their stability. The Suzuki government sees this "comprehensive security policy" as its contribution to international security. In strategically located Oman, for example, Japanese economic aid is disproportionate to Japan's minimal economic ties and Oman's limited development potential. [redacted] 25X1

Egypt is another case in point. In the mid-1970s, the Foreign Ministry recognized Egypt's importance in the Middle East equation and was sympathetic to the US call for additional aid. Finance Ministry officials, however, continued to argue for channeling assistance to countries where Tokyo could expect a direct economic return. Now, Egypt ranks behind only ASEAN and China as a recipient of total Japanese official development assistance. [redacted] 25X1

Tokyo's preliminary decision last month to increase aid to Egypt, Oman, Sudan, and North Yemen reflected its concern for stability in the region following Sadat's assassination. The level of aid will be worked out in budget negotiations between the Ministries of Finance and Foreign Affairs. [redacted] 25X1

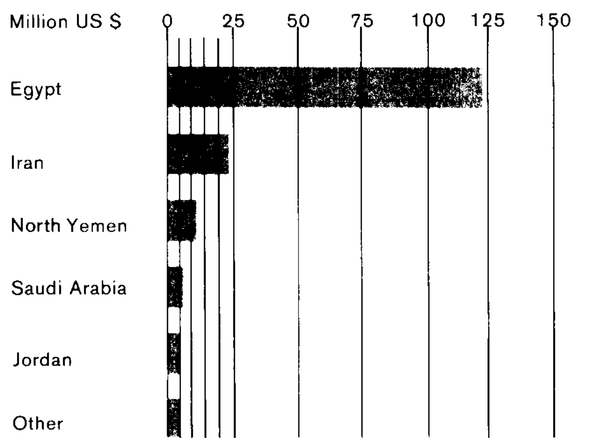
A Trend Toward Independence?

As Tokyo moves further from the economic sphere in formulating its Middle East policy, it will often choose positions that coincide with those of the United States:

- Japan perceives a Soviet threat to regional security and oil supplies.

Japan: Net Disbursements of Foreign Aid to the Middle East, 1980

Total: 172 Million US $



[redacted] 25X1

585759 11-81

- Tokyo continues to support moderate Arab states such as Saudi Arabia, the United Arab Emirates, and Jordan.
- Japan fully supports the Camp David Accords and has said that efforts to secure peace in the Middle East should continue to be based on that agreement.

Nonetheless, the government will not limit its initiatives to policies sanctioned by Washington. While it backs the Camp David peace process, Tokyo believes that the PLO must be involved if any Middle East peace negotiations are to succeed. [redacted] 25X1

This view was reflected in the decision to permit PLO leader Arafat's recent visit to Japan. Tokyo used the visit to encourage the PLO's current trend toward moderation and to urge Arafat to recognize Israel's right to exist. The Japanese also clearly hoped to win points with the Arab oil producers, who have prodded Tokyo to recognize the PLO and have long criticized what they describe as Japan's subservience to the United States. The Japanese are worried that the US attitude toward the PLO will drive it, and perhaps

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

many of the Arab states as well, into the Soviet camp. Tokyo has also expressed growing concern about possible Soviet intervention in the area, particularly in Iran. [redacted] 25X1

Tokyo probably hopes to serve as a bridge between the PLO and the United States and perhaps even between the PLO and Israel. The Japanese have shown some interest in the Saudi eight-point peace proposal and have welcomed US statements that recognized some value in the plan. In an effort to maintain a balance in its regional policy, Japan may make some gestures toward Israel but will always tune relations with Israel with an ear to Arab reaction. [redacted] 25X1

Tokyo is moving to establish clear Japanese positions on foreign policy issues. Officials are increasingly conscious of Japan's economic power and frequently question the wisdom of US policies. Reflecting this, the Japanese Foreign Ministry white paper for this year emphasizes that Japan will not be content simply to follow US or Western initiatives. [redacted] 25X1

The next step will be increased contacts with Middle East leaders. Saudi Crown Prince Fahd probably will visit Japan early next year. At that time, Tokyo will likely hold discussions on the Saudi peace plan. Prime Minister Suzuki wants to visit the region in 1982 and probably will go prepared with a solid package of economic and technical assistance. [redacted] 25X1

[redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Japan: Aiding Depressed Industries [redacted] 25X1

The Japanese Government is considering measures that would violate the spirit if not the letter of its pledge at the Ottawa summit not to subsidize structurally depressed industries. Some of the policies being debated would contradict Japan's oft-professed support for free trade. Attempts to shelter the aluminum, chemical fertilizer, pulp and paper, and petrochemical industries from import competition could easily spark an international outcry, particularly during a period when Japan's trade surplus is headed toward record levels. There is a consensus within the government that some aid should be given, but substantial disagreement exists on the international implications, revenue effects, and legality of the various proposals. The attitude of the United States could have a major influence on the outcome of the debate. Most of the decisions must be made before the budget is announced in late December. [redacted]

Impact of High Energy Prices

The problems of the four troubled industries date back to the Arab oil embargo of 1973. Unlike other Japanese industries that overcame 1973 setbacks, these have never fully recovered because of their dependence on petroleum-based feedstocks or electricity from oil-fired thermal generating plants. [redacted]

Government and industry officials debating the future of the depressed industries recognize that production processes—particularly those requiring large inputs of energy and raw materials—would be done better elsewhere and that Japan's imports of aluminum, fertilizers, basic petrochemicals, and paper must increase. Japan would prefer to import under long-term contracts or from projects in which Japanese firms are involved. Many officials, nevertheless, argue that Japan should maintain some capacity to produce basic materials at home to ensure stable supplies at reasonable prices and the technological base they believe is essential to support development projects overseas. Another compelling, but seldom stated, reason for maintaining large domestic industries is the need to pay off the substantial debts of the companies involved. [redacted] 25X1

The Aluminum Smelting Industry

Aluminum smelters are the principal industry seeking special relief. The aid it gets from the Japanese Government is apt to set a pattern for the other depressed industries. The industry's problems have been under discussion for several months within the Ministry of International Trade and Industry (MITI) and the Aluminum Committee of the Industrial Structure Council, an advisory board to MITI composed of academics, bankers, journalists, and businessmen. [redacted] 25X1 25X1

The aluminum industry is clearly in trouble. Aluminum prices have been declining since early 1980, and domestic production has fallen sharply since July 1980. Inventories have soared from less than a month's output in mid-1980 to a record five-and-a-half times monthly output in September 1981. Industry losses now surpass $400 million and total debt exceeds $4 billion. [redacted] 25X1 25X1

These losses stem from higher oil prices, stagnant demand, and import competition. The cost of electricity has doubled since the Iranian crisis and now comprises over 40 percent of the industry's cost of production. Weak demand and lower cost imports have prevented smelters from passing along the full increase in electricity costs. The Japanese complain persistently about spot market purchases of US ingot and claim that the imported price is $1,600 per metric ton (c.i.f), well under the domestic price of $2,000 to $2,200. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Impact of Proposed Countermeasures

MITI, the Aluminum Committee, industry associations, and the Ministry of Finance (MOF) have proposed to aid aluminum smelters through:

- Reduction of smelting capacity.
- Revision of the tariff on imports of aluminum ingot.
- An import surcharge with the proceeds distributed to domestic producers to assist in financing the rehabilitation of the industry.
- A prenotification system for imports to help MITI monitor the market.
- Reduction of electricity costs through indirect subsidies.

The Aluminum Committee, reflecting views within MITI, recommends a permanent reduction in annual capacity from the present 1.1 million tons to 700,000 tons. The committee forecasts that demand will rise 5 percent annually to reach 2.16 million tons in FY 1985, with annual imports of about 1.5 million tons. The source of these imports would be:

- 700,000 tons from facilities developed with the participation of Japanese producers.
- 500,000 tons under long-term contracts with foreign producers.
- A maximum of 300,000 tons from spot market purchases.

Long-term supply contracts would reduce US access to the Japanese market. The maximum 300,000-ton share allocated to spot market purchases would hold US exports to current levels. US producers are reluctant to make long-term commitments and have only recently turned to spot market foreign sales to keep production up during periods of slack domestic demand. At least one US multinational producer benefits from the emphasis on long-term contracts by shipping to Japan from third countries, but other US companies not already in the long-term game may be shut out.

In addition, the Ministry of Finance plans to raise the current 9-percent duty on aluminum ingot to 13 or 14 percent. This increase, although not eliminating the cost advantage of US smelters, could reduce the gap enough to make Japanese buyers reluctant to abandon their traditional suppliers. MITI, on the other hand, advocates a tariff-quota system that would eliminate existing duties for the 600,000 tons of ingot that would be imported annually from overseas projects involving Japanese firms during the next three fiscal years. Buyers of imported ingot would be obliged to purchase a still-undetermined quantity of domestically smelted aluminum. Elimination of the tariff is designed to win the support of ingot users, but the Finance Ministry protests that the $385 million dollar revenue loss under the tariff-quota scheme is too large in an era of tight budgets. 25X1

Another aspect of the MITI plan would circumvent the pledge Prime Minister Suzuki made at the Ottawa summit not to subsidize depressed industries. 25X1 This proposal would have a private trade association collect a 6-percent surcharge on the 600,000 tons of duty-free aluminum. The association would then funnel the money to domestic smelters. 25X1

All parties agree that the aluminum industry's electricity bills must be reduced. MITI's Basic Industries Bureau would have all industrial electric power customers pay a small subsidy to aluminum refiners. The average cost of electricity produced in oil-fired thermal power plants wholly or jointly owned by smelters, which together account for 80 percent of the aluminum industry's consumption, is slightly higher than that purchased from electric power companies. Smelters could lower their costs by selling their generation 25X1 facilities to the electric companies and then purchasing electricity at the same rate as other industrial consumers. Other MITI officials would cut costs by converting power plants from oil to coal, but this approach requires time and perhaps low-interest government loans as well. MOF would rather reduce the tax on imported fuel oil used to generate electricity for aluminum smelters. 25X1

Chemical Fertilizers

Chemical fertilizer producers suffer from the same basic problems as the aluminum industry, and MITI 25X1 would like to solve them using roughly the same plan. The industry has been hard hit by rising oil prices because it is dependent on naptha as a feedstock in the production of ammonia. In the case of ammonium phosphate, the commodity of greatest concern to MITI, there is no tariff. A 10-percent duty would be imposed on imports exceeding a still-undetermined level. Almost all of Japan's $55 million in ammonium phosphate imports during 1980 came from the United

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

States. The purchasers of ammonium phosphate exempted from the new tariff would then be obliged to buy specified quantities of domestically produced fertilizer or pay a surcharge to an industry association that would funnel the money to domestic producers. The tariff would not eliminate the price advantage of imported fertilizer, but it would narrow the gap sufficiently for the domestic industry to retain most of its customers. As in the case of aluminum, the tariff quota would shift the burden of adjustment from domestic to US producers. [redacted]

Over the long term, MITI acknowledges that ammonia producers must switch from naptha to non-petroleum-based feedstocks such as coke oven gas or coal. Two Japanese companies have already worked out plans for the changeover; MITI would like to encourage the process by arranging government-backed low-interest loans. Subsidies for the chemical fertilizer industry, whether in the form of low-interest loans or a surcharge on imports, would enable Japanese companies to sustain higher levels of capacity and production and would reduce the opportunity for US firms to export to Japan. [redacted]

Pulp and Paper

Although the high price of energy adds to the pulp and paper industry's difficulties, its primary problem is excess capacity. To curtail output and price cutting, the government has approved the formation of temporary (three-to-six-month) cartels by producers of high-grade printing paper, coated paper, and low-grade kraft paper. In addition, MITI is contemplating a tariff-quota system to protect the entire industry. The ministry is also planning to use administrative guidance to halt construction of new production facilities for the next two years. [redacted]

Limitations on capacity could open new opportunities for US exports if Japanese demand for paper increases. In practice, however, a successful freeze would probably involve some form of domestic orderly marketing agreement among existing producers that would impede the access of US exporters. The Japan Fair Trade Commission believes such administrative guidance may constitute an illegal production cartel, and the threat of prosecution for violation of the Anti-Monopoly Law could make producers reluctant to follow MITI's lead. [redacted]

Petrochemicals

As in the chemical fertilizer industry, the problem is the cost of naptha, the petrochemical industry's basic feedstock. Also, the growth rate of domestic demand for petrochemicals has slowed. Moreover, US and Canadian producers, who enjoy access to cheaper natural gas feedstocks, have mounted an export offensive in Southeast Asia, the Japanese industry's traditional market, and in Japan itself. Although controls on the price of natural gas in the United States and Canada contribute to the cost differential, Japan's 25X1
aging, naptha-based petrochemical plants would still not be competitive even if controls were eliminated. [redacted] 25X1

The industry's problems are still under study and little is known about how much assistance Tokyo is likely to provide. MITI would like to place the industry under the Structurally Depressed Industries Law to facilitate mergers. In MITI's view there are too many companies engaged in the manufacture of petrochemicals and less competition would yield higher profits per company. Without higher profits MITI believes the industry will be unable to fund the 25X1
research and development necessary for its survival. [redacted] 25X1

The Debate Goes On

Although the government agrees that some aid must be offered, the ministries are still squabbling over the desirability of specific proposals and who should bear the costs:

- MOF is concerned about the potential loss of tariff revenue under the MITI plans and wants to raise tariffs instead.
- MITI believes that the MOF's tariff hike will not provide enough protection. 25X1
- MITI would reduce competition in some industries to strengthen corporate finances.
- The FTC believes the Anti-Monopoly Law must be enforced.

Even within MITI there is substantial disagreement. The International Trade Bureau is worried that new trade barriers would precipitate protectionist actions by the United States and the EC [redacted] 25X1

For the government, however, the time of decision is quickly approaching. The FY 1982 budget, which begins on 1 April, is in the final drafting stage, and 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

issues such as tariffs and low-interest loans must be worked out before it is submitted to the Cabinet in late December. MITI is trying to overcome MOF objections to a tariff-quota system for aluminum by securing US "understanding" of how the system works. In Washington, the Japanese are likely to emphasize formal tariff "cuts" but say little about informal surcharges or obligations to purchase domestic product. They may also neglect to mention that adoption of a tariff quota for aluminum will spur other depressed industries to demand similar treatment. A clear-cut US objection to tariff quotas or other like proposals would strengthen the hand of opponents in Japan. MITI, MOF, and the other actors will probably continue to jockey for position during November and early December. Final decisions are not likely until after the trade consultations with the United States on 7-9 December 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

The Philippines: Politics of Economic Reform 25X1

A faltering economy is forcing President Marcos to institute reforms that could result in a major realignment of economic groups and alter the political balance in the early 1980s. Economic interests favored by Marcos stand to lose as a result of foreign trade and financial reforms required to ensure continuing credits from the World Bank, the IMF, and private foreign bankers. Influential industrial oligarchs may seek to shift political loyalties rather than adapt to the new rules that reform could produce. Marcos, however, cannot defer the scheduled reforms without risking worse economic problems in the years ahead.

The Setting

Only the reconstruction after World War II and the foreign exchange crisis of 1969-70 forced radical economic policy changes. In between these crises, the elite used its political ties to protect vested economic empires.

Recent economic performance could produce a third major shift in the domestic political balance. Public and private expansion of the foreign debt, which has fueled the 6-percent annual growth since 1970, is now producing financial strains. At the same time, the worldwide economic slowdown and a domestic liquidity crisis are beginning to touch interests close to Marcos. Early in 1981, a dozen large manufacturing firms, including several conglomerates run by Marcos's close allies, faced cash shortages because of slow sales and rising foreign debt service payments. Pressed to provide financial assistance in the form of loans, equity capital, and restructuring of short term obligations, Philippine banking authorities have been charged with overseeing both reform of the financial system and the management of the troubled corporations. Manila is also reforming economic policies that support a lagging manufacturing sector in return for World Bank and IMF balance-of-payments financing (see table). 25X1

The reforms of trade and financial policies that have been pledged are producing economic dislocation and criticism of the government. Labor relations remain unsettled after a series of strikes last summer and a rise in unemployment to 9 percent, about double the rate a year ago. In the face of a worsening trade deficit and growing layoffs in several major industries, several prominent businessmen have urged that tariff 25X1 reductions be postponed and have pressed the Central Bank to defend a deteriorating exchange rate.

Marcos, Inc. 25X1

Marcos's political allies tend to owe their financial success to palace influence, not business acumen. They control major sectors of the economy, benefiting from special legislation or selective enforcement of 25X1 government regulations. Major government projects are contracted out to Marcos's associates, who also act as middlemen for businesses without direct contacts in the palace. 25X1

Tariff reform and an end to import licensing will press Marcos's allies by exposing their interests to more efficient—and previously excluded—foreign competition. Some associates could lose large sums from a policy of flexible exchange rates, which would boost the peso value of scheduled foreign debt repayments. The Marcos family itself, one of the richest in Asia, faces potentially large financial losses from its industrial holdings because of reforms pledged to the World Bank and the IMF. 25X1

The Technocrats

Manila's largely US-trained staff of economic technocrats is to arrange the details of the reform program 25X1 and to design and implement all economic policy. Its power derives solely from the backing Marcos gives it. For his part, Marcos uses the credibility of the

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

The Economic Reform Package

Reform	Mandated by	In Exchange for	Remarks
Tariff reductions, ending import licensing, realigning domestic taxes, export promotion, streamlining foreign investment regulations.	World Bank	1980-81 $200 million loan for industrial restructuring. First of as much as $600 million over three years. Program identifies structure of the economy as the source of fundamental balance-of-payments problems. Undertakes long-term solution by restructuring indigenous manufacturing.	Targeted at home goods industries for purpose of ending barrier to foreign competitors. Phased in, 1980-85. Tariff reform and import licensing will hurt profitability of domestic steel, cement, textile, paper, machinery, food processing, and chemicals. Ending import licensing will reduce black market for foreign exchange. Tax realignment. Replaces revenue lost due to tariff reform. Raises non-trade taxes. Export promotion provides incentives, financing to exporters. Expansion of export zones. Prelude to 1980-81 World Bank loan. Streamlined regulations aimed at accelerating investment. Reduces crowded industries list. Will end advantage long held by politically well-connected interests in local manufacturing.
Restrictions on money supply expansion, restrictions on Central Bank credit to government, limits to commercial foreign borrowing, and flexible exchange rate policy.	IMF	1980-82 $472 million standby loan from Supplementary Financing Facility. Program identifies former domestic stabilization policies as cause of short run balance-of-payments problems. Augments international reserves while undertaking medium-term solution.	Intended to reduce domestic inflation, protect competitiveness of exports. Central Bank restrictions limit ability of Central Bank to monetize budget deficits. Commercial borrowing limits continue condition on 1978-79 standby from Extended Fund Facility. Flexible exchange rate protects competitiveness of exports and reduces attractiveness of imports, reducing trade deficit. Boosts profitability of investing in export enterprises. Reduces profitability of local manufacturing.
Financial reform—liberalization of interest rate policy.	World Bank and IMF	Same as above.	Intended to increase availability of local financing and promote development of local capital markets. Reduces value of being politically well connected.
Financial reform—ending swap financing and quasi-banking.	Informal pressure by international financial community	Continued good credit rating.	Intended to place local finance on sounder footing. Illegal quasi-banking permitted politically well connected to raise funds without equity. Swaps permitted them to borrow abroad at low rates with government guarantee and reinvest funds locally at higher rates.
Restructuring financial empires of Marcos's associates.	Technocrats, with Marcos's sponsorship	Financial assistance from government banks.	Extremely politically sensitive. Protects interests of foreign creditors.

25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

technocrats to reassure nervous foreign investors and creditors about the economy's capacity to repay foreign debt and maintain a predictable investment climate.

Cesar Virata, ex-Governor of the World Bank and Finance Minister since 1970, was named Prime Minister last July explicitly to meet Marcos's need to present an image of economic responsibility. Another respected economist, Central Bank Governor Jaime Laya, is overseeing reform of the Securities and Exchange Commission and is to handle the sensitive task of restructuring the empires of Marcos's associates. The technocrats, who are in direct conflict with politically well-connected interests, recently lost a battle to suspend a politically sensitive levy on domestic coconut sales and exports.

The Spectators

Other domestic interest groups exert marginal influence on economic decision making or perceive little stake in the reform package. The old oligarchy—a politico-economic elite of about 400 families tracing its roots to Spanish colonial days—has been neutralized through expropriation, intimidation, and, more often, cooption. Those with palace connections behave much like Marcos's cronies and probably oppose change. Others, although resentful of the favoritism shown Marcos's associates, appear content to protect their holdings through their extensive foreign business connections.

The million ethnic Chinese, who are well established in textiles and banking, have varied views on reform. Several Chinese firms recently benefited from rights conferred by Marcos making them marketing houses for Philippine exports. Textile firms will benefit from reform through access to loans for modernizing manufacturing facilities but will face a profit squeeze from tariff reductions and the ending of foreign exchange controls. Financial reform also will open Chinese financial operations to greater scrutiny by Philippine banking authorities.

Both the military and the work force of 18 million people are passive bystanders for the moment. The military has prospered under Marcos and should continue to do well even in a reformed, export-oriented economy. Although the work force will benefit when a postreform economy eases the job market and reverses recent declines in real wages, it will suffer short run dislocation from unemployment produced by tariff reductions and a more flexible exchange rate policy.

25X1
25X1

The Foreigners

Foreign firms and financial institutions—mainly international financial institutions, private commercial banks, and largely US industrial corporations—are the only economic power center beyond Marcos's control. Their influence grew as the two large OPEC price hikes necessitated growing borrowing to cover external payments. The Philippines' total foreign debt reached $15.4 billion by September 1981. Under the best of circumstances, annual repayment obligations could easily triple to $4.5 billion by 1985.

25X1
25X1

The World Bank and the IMF require reforms aimed at the root of the payment imbalance—the home goods sector of domestic manufacturing, which includes industries such as cement, steel processing, food processing, pulp and paper, and textiles. A $200 million World Bank credit in 1980 for industrial restructuring calls for lower tariffs, an end to import licensing, and realignment of the domestic tax system to make the home goods sector internationally competitive. A recent $472 million, 22-month credit from the IMF's Supplementary Financing Facility requires a flexible exchange rate policy and reform of the financial system, tight money policies, and continued limits on commercial foreign borrowing pledged to secure earlier credits.

25X1
25X1

Foreign commercial banks, mostly US, have been covering about half the economy's annual foreign exchange gap without formally insisting that Manila adhere to reform conditions. By the end of this year, US banks will be holding nearly $2 billion in medium- and long-term claims on Philippine borrowers and will be providing most of the economy's short-term financing. Manila's dependence on these credits, coupled with the bankers' aversion to any sign of financial abuse, has served as another check on Philippine economic policy making. Private banks thus serve as important informal sponsors of economic reform.

25X1
25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Looking Ahead

Marcos is well aware of the political costs of the reform package. His sensitivity was demonstrated earlier this year when he announced that "grace periods" would be awarded several industries facing new foreign competition because of the reform measures. Marcos, nonetheless, has implemented the first phases of trade policy reform by reducing the country's highest tariffs. In January 1982, he is scheduled to implement the elements of tariff reform and foreign exchange decontrol that are most politically sensitive. 25X1

Marcos cannot avoid further reform whatever his political calculations. The economy's current account deficit will probably reach a record $2.7 billion this year or 6.5 percent of GNP. This level is not sustainable for more than another two or three years if the Philippines is to maintain a favorable international credit rating. Should Marcos violate IMF and World Bank conditions, commercial financial assistance would be available only at prohibitive terms. 25X1

Marcos's most critical task will be to find ways to turn the reforms to his advantage. The reforms could achieve the stability in the external accounts that Marcos wants as a legacy of his economic management. The reforms, however, may force Marcos to develop ties to a new and different politico-economic elite. If he cannot, by the mid-1980s he may be faced with a political and economic climate less congenial to his continued tenure or that of his family and friends. 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

East Asia Briefs

China

Wang Enmao Returns as Xinjiang Party Boss

The leadership hopes Wang, who held a succession of key political and military posts in the province until he was purged in the Cultural Revolution, will be able to halt continuing unrest in this strategic region. Periodic fighting between nationalistic minorities and ethnic Chinese, disturbances by rusticated Chinese, grumbling in Army units garrisoned there, and reported efforts by the Soviet Union to foster discord are troubling Beijing. And Deng Xiaoping and Hu Yaobang also are concerned about lingering support in the provincial party committee for ousted Party Chairman Hua Guofeng. [redacted] 25X1

In the past, Wang, a tough, no-nonsense military man, has strongly advocated a moderate policy toward minorities—one very similar to that advocated by Hu Yaobang today. Still, Wang has not hesitated to take decisive action to maintain order among Xinjiang's restless minorities. In a speech at the time of his appointment in late October, Wang set out his priorities: maintain order, strengthen border defenses, and see that central policies are enforced. [redacted] 25X1

Record Trade Surplus Posted

China's trade balance for the second quarter of 1981 rebounded sharply from a first-quarter deficit of $500 million to a surplus of $1.1 billion. Exports grew moderately—about 9 percent—while imports declined 20 percent. Both the direction and commodity composition of trade during the first half reflected economic readjustment policies favoring light industry and agriculture over heavy industry. [redacted] 25X1

High world prices and anticipated good harvests contributed to declining imports of cotton and grains. China relied on cheaper grain markets in Canada and Australia, avoiding expensive US sources. Reduced deliveries of manufactured goods, particularly machinery from Western Europe and Japan, also contributed to lower import costs. [redacted] 25X1

Chinese exports rose by $480 million to about $5.7 billion during the second quarter. All the growth came in non-Communist markets. [redacted] 25X1

During the quarter, China repaid $35 million of the $553 million it drew from the IMF under its first credit tranche. China also retired $24 million of $380 million in IMF trust fund loans. By the end of June, China also repaid $1.4 billion of its record borrowing of $6.5 billion from foreign commercial banks. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Secret

China: Imports, Exports, Trade Balances, F.O.B., By Area, 1979, 1980, 1981

Billion US Dollars

	Imports				Exports				Trade Balances			
	1979	1980	1981 1st Qtr.	1981 2nd Qtr.	1979	1980	1981 1st Qtr.	1981 2nd Qtr.	1979	1980	1981 1st Qtr.	1981 2nd Qtr.
World	**14.4**	**19.4**	**5.7**	**4.6**	**13.8**	**19.6**	**5.3**	**5.8**	**−0.6**	**0.2**	**−0.4**	**1.2**
Non-Communist countries	**12.4**	**17.4**	**5.2**	**4.2**	**12.0**	**17.6**	**4.8**	**5.3**	**−0.4**	**0.2**	**−0.4**	**1.1**
Developed countries	10.2	13.5	3.8	3.1	5.6	8.3	2.2	2.4	−4.5	−5.2	−1.6	−0.7
East Asia and Pacific	4.5	6.1	1.7	1.6	3.0	4.4	1.1	1.3	−1.5	−1.6	−0.6	−0.3
North America	2.2	4.5	1.4	0.9	0.7	1.2	0.4	0.5	−1.5	−3.3	−1.0	−0.4
Western Europe	3.4	2.9	0.8	0.7	1.9	2.7	0.7	0.6	−1.5	−0.3	−0.1	−0.1
Less developed countries	2.3	3.9	1.3	1.1	6.4	9.4	2.6	2.8	4.1	5.5	1.2	1.8
Southeast Asia	0.9	2.0	0.6	0.6	4.3	6.3	1.7	1.9	3.4	4.3	1.1	1.3
South Asia	0.1	0.4	0.3	0.1	0.3	0.3	0.1	0.1	0.1	NEGL	−0.2	NEGL
Middle East	0.2	0.3	0.1	0.1	0.8	1.1	0.3	0.3	0.6	0.8	0.2	0.2
North Africa	0.1	0.1	0.1	NEGL	0.2	0.3	0.1	0.1	0.1	0.1	NEGL	0.1
Sub-Saharan Africa	0.2	0.3	0.1	0.1	0.6	0.9	0.2	0.3	0.4	0.6	0.1	0.2
Latin America	0.8	0.8	0.2	0.2	0.3	0.5	0.2	0.2	−0.5	−0.3	NEGL	NEGL
Communist countries	**1.9**	**2.0**	**0.5**	**0.4**	**1.8**	**2.0**	**0.5**	**0.5**	**−0.2**	**0.0**	**NEGL**	**0.2**
USSR	0.3	0.3	NEGL	NEGL	0.2	0.2	NEGL	NEGL	NEGL	NEGL	NEGL	NEGL
Eastern Europe	1.2	1.3	0.3	0.3	1.1	1.3	0.4	0.4	−0.1	NEGL	NEGL	0.1
Other	0.4	0.4	0.1	0.1	0.4	0.4	0.1	0.1	NEGL	NEGL	NEGL	NEGL

25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Industrial Renovation Bogs Down

A plan to use Western assistance to upgrade 55 industrial facilities has proved to be nearly as time-consuming and expensive as new construction. The renovation program was designed to forestall huge outlays for new plants and to avoid repeating mistakes that resulted in importing several costly but inefficient projects during the 1970s. 25X1

25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Improved Tank Demonstrates Interim Modernization

An improved medium battle tank unveiled last month in the Beijing Military Region illustrates China's intention to upgrade selected weapon systems even in a time of economic austerity. [redacted] 25X1

The improved tank—designated Type 69—appears to have capabilities similar to the Soviet T-62, the most advanced Soviet tank currently deployed on China's borders. Mounted on the same chassis as China's 1950s-vintage Type 59, the new tank is equipped with a larger main gun. It has better capability for firing on the move, advanced communications and target sighting equipment, and better night vision capabilities. The tank's smoothbore cannon—probably 105 mm—can fire conventional high-explosive or advanced armor-piercing ammunitions. The new gun probably has greater range and accuracy than those on other Chinese tanks. 25X1

[redacted] 25X1

[redacted] Beijing is offering the improved tank—without the new main gun—for export. [redacted] 25X1

New Antitank Missile Not Yet Operational

A parade last month near Beijing included 20 jeeps carrying missiles that appear identical to the Soviet Sagger AT-3—a manually controlled, wire-guided system designed to destroy tanks at distances up to three kilometers. Although the missile has been shown in the press and on television since 1979, PLA officials have admitted privately that the system is still in testing. The Chinese reportedly are having problems in producing the fine filament wire necessary for guidance. [redacted] 25X1

Deployment of such an antitank guided missile along the Soviet border would at least temporarily reduce the 2.6-to-1 Soviet advantage in numbers and effectiveness of tanks and antitank weapons. The missile probably is not effective against the more heavily armored T-64 and T-72 tanks that the Soviets are expected to deploy there. China has tried to obtain more powerful and accurate antitank missiles from France and the United Kingdom, and Beijing is interested in the US TOW and Dragon systems. [redacted] 25X1

[redacted] 25X1

Northeast Asia

Japanese Politics on Schedule

Prime Minister Suzuki's priority legislation, the administrative reform program, is moving smoothly through the Diet, with final passage almost certain by the end of this month. Suzuki is now turning his attention to reorganizing the Cabinet and LDP leadership later this month or early in December, an annual exercise that gives veteran party members their turn at important posts. Speculation is focusing on whether top contenders to succeed Suzuki—Nakasone, Miyazawa, Komoto—

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

will remain in the Cabinet and whether anti-Sonoda elements in the party and bureaucracy will succeed in ousting him from the Foreign Ministry. The betting has the contenders staying and Sonoda going. [redacted] 25X1

Suzuki's stock is up as a result of his handling of the administrative reform package, and the Cabinet shuffle will give him another opportunity to reinforce his position. He will have to move cautiously, however, if he is to avoid the factional fighting that crippled the party in the late 1970s. His task has been complicated by developments in the Lockheed bribery trial that have hurt one of his supporters, faction leader Tanaka. Damaging testimony and the conviction of a close friend and financial backer have clouded Tanaka's political future. [redacted] 25X1

P'yongyang Still Grappling With the Economy

The North Koreans have reorganized the State Administration Council—the country's Cabinet—in an effort to strengthen centralized control of the economy and improve industrial coordination:

- Thirteen industrial ministries were merged into four committees in September; several other ministries were abolished.
- Agricultural and noneconomic ministries were not directly affected.
- Some functions of the ministries involved were turned over to the Economic Guidance Committees, which were established in each of the nine provinces and in four cities to oversee local economic activity.
- Chairmen of these provincial committees were given ministerial rank and sit on the Council. [redacted] 25X1

No purge of the bureaucracy accompanied this sweeping reorganization, although many high-level officials were reassigned. The changes may eliminate some local production bottlenecks, but they will do little to resolve broader economic problems and are bound to complicate drafting of the 1982 economic plan. [redacted] 25X1

Southeast Asia

Australia Beefing Up the Military Budget

Australia's new military expenditure program is its largest ever. The $4.7 billion budget for the fiscal year ending 1 July 1982 represents an increase of 5 percent in real terms and will account for 10 percent of Canberra's total budget outlays. The defense budget provides for the construction of new military bases, the upgrading of existing ones, and new factories to produce military equipment and ammunition. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Canberra appears determined to rebuild its military, which has been neglected since the Vietnam war. It plans to purchase 75 F/A-18 Hornets to replace 90 aging Mirages as part of a reported $5.75 billion long-range military equipment acquisition program. The purchase, to cost $2.9 billion over the 1984-90 delivery period, will be the largest single defense equipment acquisition in Australian history. [redacted] 25X1

Philippine Foreign Debt Climbing

Foreign debt rose at an annual rate of 30 percent during the first three quarters of 1981, reaching $15.4 billion at the end of September. The surge is largely an outgrowth of a poor trade performance that will probably push the deficit this year to a record $2.6 billion. The interest payment portion of debt service jumped 52 percent in January-September and consumed nearly $1 billion in foreign exchange, versus $638 million during the same period in 1980. [redacted] 25X1

Manila nevertheless has had little difficulty securing new foreign credits. The Central Bank has lined up a manager for the first loan in its 1982 Consolidated Foreign Borrowing Program, which in turn will be lent to private borrowers. [redacted] 25X1

[redacted] 25X1

Malaysia Accelerating Foreign Borrowing

Arrangement of a $650 million foreign loan in mid-October reflects Kuala Lumpur's desire for an aggressive start on its ambitious Fourth Malaysia Plan (1981-85). Malaysian policymakers had hoped to tap multilateral agencies for financing the first few years of the development plan and to reserve heavy commercial borrowing for the plan's last years. This strategy was derailed by weak international commodity prices for rubber and tin and a glutted international oil market that have weakened the country's balance of payments. [redacted] 25X1

The new loan will cover nearly half this year's estimated $1.5 billion current account deficit, thus sparing Kuala Lumpur from having to slow imports of capital goods for development programs or adjust the exchange rate. The international banking community apparently remains bullish on Malaysia's long-term economic prospects. The loan is among the largest secured by an Asian borrower this year, was fully subscribed within a week, and carried very favorable terms. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Ne Win Steps Aside as President But Not as Policymaker

San Yu assumed the presidency of Burma on 9 November, but Ne Win's election to another four-year term as party chairman at the August party congress ensures that the 70-year-old leader will remain the dominant political force. San Yu's role as president will be limited. He was dropped at the congress from the party Central Executive Committee—the premier decisionmaking body. [redacted] 25X1

Regional Development

Growing Indonesian–South Korean Energy Links

Cooperation in the energy field has increased following agreement earlier this year for joint oil exploration and Indonesian liquefied natural gas exports to South Korea. Jakarta wants to diversify its LNG exports, which now go entirely to Japan, and Seoul stands to gain a more secure supply of energy imports. [redacted] 25X1

Pertamina (Indonesia's state oil company) and Kodeco (the government-owned Korean Development Company) are moving ahead with their joint venture to explore for oil offshore East Java. As part of its $60 million commitment on exploration during the next six years, Kodeco plans to drill eight exploratory wells by 1984 after completing seismic studies next May. South Korea's share of any commercial output will supplement the 15,000 b/d of crude oil it currently purchases from Indonesia. [redacted] 25X1

Both sides are proceeding with plans for the start of LNG shipments even though financing arrangements have not yet been settled and deliveries are not scheduled before 1985. Following President Chun's visit to Indonesia last June, Seoul agreed in principle to purchase 1.5 million tons of LNG annually (about 40,000 b/d oil equivalent) from the Arun field in North Sumatra and has already selected a site for an LNG import terminal. [redacted] 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Calendar of Coming Events

November

18-20 November
ASEAN-US Joint Business Council/Financial Conference, Kuala Lumpur 25X1

Mid-November
The Fourth Session of China's Fifth National People's Congress reportedly will convene around 20 November. 25X1

23-27 November
An international oil conference, "Offshore China '81," will be held in Guangzhou. 25X1

30 November
KPNLF leader Son Sann will arrive in the US for a speaking tour sponsored by "Food for the Hungry." He wants to speak to US officials on the Kampuchean situation and is expected to renew requests for aid. 25X1

30 November–5 December
Secretary of Transportation Lewis visits Japan. 25X1

Late November–Early December
Annual reshuffle of Cabinet and LDP leadership anticipated. 25X1

December

1 December
The Clean Government Party's convention is expected to endorse support for the Self Defense Forces, alliance with the US, and improved relations with South Korea. 25X1

7-11 December
US-Japan Trade Facilitation Committee and Trade Subcommittee meet in Tokyo. 25X1

12 December
Second anniversary of the "headquarters coup" in which Chun Doo Hwan—then a major general—and a core group of key combat commanders seized control of the South Korean Army, thus paving the way for Chun's ascension to the presidency. 25X1

15 December
Chinese Vice Premier Gu Mu arrives in Tokyo for Japan-China ministerial talks; agreement will be announced on settlement of controversy caused by Chinese plant cancellations. 25X1

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8

Secret

Approved For Release 2007/06/20 : CIA-RDP03T02547R000100030001-8